First-Time Home Buyer Savings Accounts

May 16, 2013

Proposed Legislation

First-Time Home Buyer Savings Accounts

- Would allow an individual to establish a first-time home buyer savings account on behalf of a qualified beneficiary or beneficiaries in order to apply distributions from such account toward eligible costs.
  - "First-time home buyer savings account": an account established at a financial institution by an account holder.
  - "Qualified beneficiary": an individual who resides in Virginia and who:
    1. Has never owned or purchased a single-family residence;
    2. Is designated as the beneficiary of a first-time home buyer savings account; and
    3. May apply funds held in such account for eligible costs.
  - "Eligible costs": the down payment and allowable closing costs for the purchase of a single-family residence in Virginia by a qualified beneficiary.

Tax Consequences

Subtraction for Interest or Other Income

- An account holder would be allowed to subtract all interest or other income earned that is attributable to an account from his federal adjusted gross income for Virginia income tax purposes.
- Such income would still be subject to federal income taxation.

Addition for Loss Deducted as a Capital Loss

- An account holder would be required to add back any loss deducted as a capital loss for federal income tax purposes that is attributable to an account to his federal adjusted gross income for Virginia income tax purposes.

Comparison with Section 529 Plans

Virginia College Savings Plans ("Section 529 Plans")

- Taxpayers may set up tax-advantaged college savings plans.
- Interest earned on such plans is generally exempt from federal and Virginia income tax.
- Virginia also allows an individual income tax deduction of up to $4,000 for the amount paid or contributed during the taxable year to a 529 plan.

First-Time Home Buyer Savings Accounts

- Interest earned on accounts would be exempt from the Virginia income tax, but not the federal income tax.
- There would be no state or federal deduction for **contributions** to such accounts.

Principal and Interest

Contribution Limitations

- There would be an aggregate limit of $50,000 on the amount of principal that could be contributed to an account.
- Only cash and marketable securities would be allowed to be contributed to an account.

Unlimited Account Balance

- There would be no limitation on the amount of principal and interest or other income derived from the principal that could be retained within an account.

Impermissible Withdrawals

Percentage Penalty

- If funds are withdrawn from an account for any purpose other than eligible costs, then a penalty would be imposed equal to 5% of the accumulated interest, capital gain, or other income in the account prorated to the amount so withdrawn.
  - The account holder or his estate would be required to pay the 5% penalty to the Department.

Addition for Impermissible Withdrawals

- The account holder would also be required to add back an amount equal to the accumulated interest, capital gain, or other income in the account, prorated to the amounts withdrawn from the account for purposes other than eligible costs, to their federal adjusted gross income for Virginia income tax purposes.

Impermissible Withdrawals

Percentage Penalty and Addition Example

- A taxpayer has $49,000 in principal and $1,000 in interest in an account and withdraws $25,000 from the account for an impermissible purpose.
- The amount of the interest in the account, prorated to the amount of the impermissible withdrawal, equals $500:
  - $1,000 interest /$50,000 total account funds = 2%.
  - 2% x $25,000 withdrawal = $500 prorated amount of interest.
- The taxpayer must add back the $500 prorated amount of interest to his federal adjusted gross income.
- The taxpayer is also subject to a penalty of $25.
  - 5% x $500 prorated amount of interest = $25 penalty.

Impermissible Withdrawals

Penalty Exceptions

- Neither the percentage penalty nor the addition for an impermissible withdrawal would apply if the withdrawal is:
  - By reason of the qualified beneficiary's death or disability;
  - A disbursement of assets of an account by the account holder pursuant to a filing for protection under the United States Bankruptcy Code; or
  - A transfer of the assets in an account into another first-time home buyer savings account for the benefit of another qualified beneficiary.

Administration of an Account

Responsibilities of the Account Holder

- The account holder would be responsible for the use or application of account funds.
- The account holder would:
  - Not be allowed to use funds held in an account to pay expenses of administering the account, except that a service fee would be allowed to be deducted from the account by a financial institution;
  - Be required to maintain documentation of the segregation of funds in separate accounts and documentation of eligible costs;
  - Be required to file, with the account holder's Virginia income tax return, forms developed by the Department regarding the treatment of such accounts; and
  - Be required to remit to the Department any taxes or penalties imposed.

Administration of an Account

Financial Institutions

- Financial institutions that maintain first-time home buyer savings accounts would not be subject to additional administrative, reporting, or other obligations or requirements for such accounts.

Revenue Impact of Proposed Legislation

Revenue Impact of the Subtraction*

Fiscal Year	Revenue Impact
2013	($0.00)
2014	($0.03 million)
2015	($0.08 million)
2016	($0.30 million)
2017	($0.59 million)
2018	($0.73 million)
2019	($0.74 million)

*Based on data from the Virginia Realtors Association (Virginia home sales) and data from the National Association of Realtors Confidence Index (percentage of buyers that are first-time home buyers). These estimates assume an interest rate ranging from 0.25% to 4.08% for Taxable Years 2013 through 2019 and a forecasted participation rate ranging from 50% to 90% for Taxable Years 2013 through 2019.